October 9, 2003

To The Honorable, The City Council:

INTRODUCTION

The following recommendations reflect legislative changes achieved by a legislative override of the Governor's veto allowing the City to increase the Residential Exemption from 20% to 30%. This change is based on a home rule petition adopted unanimously by the City Council on September 23, 2002.

RECOMMENDATIONS

1. That the City Council authorize the further use of Free Cash of $6,175,000 to offset the 2004 tax rate as follows:

   a. Operating Budget: $1,950,000 as adopted in the FY2004 Budget
   b. Public Investment: $2,225,000 as adopted in the FY2004 Budget
   c. Tax Support Reduction: $2,000,000

2. That the City Council classify property within the City of Cambridge into the five classes allowed for the purpose of allocating the property tax. It is further recommended that the City Council adopt a minimum residential factor of 56.3907%

3. That the City Council approve the maximum residential exemption factor of 30% for owner occupied homes, which should result in a residential tax rate of $7.63 and commercial tax rate of $19.08 upon final approval by the Massachusetts Department of Revenue.

4. That the City Council vote to double the normal value of the statutory exemptions.

5. That the City Council vote to increase the FY2004 exemption allowed under Massachusetts General Laws (MGL) Chapter 59, Section 5, Clause 17D from $219.78 to $227.65, as allowed by state statute.

6. That the City Council vote to increase the income limit for deferral of real estate taxes by elderly persons from $20,000 to $40,000, as allowed under MGL Chapter 59, Section 5, Clause 41A.

7. That the City Council accept the provisions of MGL, Chapter 184, Section 51 pertaining to changes in Clause 41C to elderly property tax relief by:

a. Reducing the age of eligibility from 70 to 65.
b. Increasing income limits for single persons from $13,000 to $20,000; and for married couples from $15,000 to $30,000.
c. Increasing asset limits for single persons from $28,000 to $40,000 and for married couples from $30,000 to $55,000.
d. Increasing the number of housing units to be exempt from the whole assets class from 2 to 3 units plus the applicant's unit (4 family units).
e. Change the amount of elderly exemption from $500 to $1,000 (100% increase). This law will apply to the FY2004 tax bill.

SUMMARY

The establishment of the property tax rate by the Board of Assessors with the approval of the Massachusetts Department of Revenue is the final step in the annual fiscal process that begins in the Spring of each year with the submission of the annual budget to the City Council. The FY2004 budget adopted by the City Council in June called for a tax levy of $210,552,978, a 6.5% increase over FY2003. After a series of adjustments, the final levy for FY2004 is $209,599,396.

Adjustment	Amount
State Aid Impact	+ 635,487
Revenue Decreases	+ 161,535
Additional Free Cash	- 2,000,000
Overlay Adjustment	+ 249,396
Net Decrease	**953,582**

While the gross levy is increasing by $11,878,851 (6.0%), a significant portion of the levy increase will be covered by taxes on newly constructed property ($11,255,761), pending approval of the Department of Revenue Bureau of Local Assessment.

For FY2004, the total assessed value of taxable property in the City of Cambridge totals $19,226,572,680 a 8% increase over 2003 values. Tables I and II below break out new tax and value growth by property types.

TABLE I
New Construction Breakdown in FY2004

Property Class	New Value	FY2004 Taxes Paid By New Value
Commercial Property	$417,269,254	$ 7,790,431
Personal Property	$124,479,950	$ 2,324,041
Residential Property	$157,226,461	$ 1,141,289
Total New Growth	**$698,975,665**	**$11,255,761**

TABLE II
Assessed Values
(in millions)

	FY00	FY01	FY02	FY03	FY04
Commercial Property	$ 3,990	$ 4,701	$ 6,215	$ 6,563	$ 6,625
Personal Property	$ 275	$ 293	$ 305	$ 368	$ 444
Residential Property	$ 6,773	$ 7,709	$10,317	$10,820	$12,158
Total Assessed Value	**$11,038**	**$12,703**	**$16,837**	**$17,751**	**$19,227**

For FY2004 the City was able to increase its levy limit by approximately $17 million, to $251 million. Approximately $11 million of this increase was due to new construction. State law allows the City to increase its tax levy limit by an amount equal to the total FY2004 value of newly constructed or renovated property multiplied by the FY2003 tax rate. The remaining $6 million is the 2.5 percent increase over the FY2003 levy allowed by Proposition 2½ plus a revised new value calculation from FY2003. The City's excess levy capacity increased by 14.5% to $41.4 million.

TABLE III
Tax Levy/Tax Levy Limit/Excess Levy Capacity
(in thousands)

	Actual FY00	Actual FY01	Actual FY02	Actual FY03	Estimated FY04
Levy Limit	$189,475	$202,213	$217,907	$233,914	$251,018
Actual Levy	$164,000	$178,485	$187,445	$197,721	$209,599
% Actual Levy Increase over Prior Year	3.1%	8.8%	5.0%	5.5%	6.0%
Excess Levy Capacity	$ 25,475	$ 23,728	$ 30,462	$ 36,193	$ 41,419

In addition to providing greater flexibility under Proposition 2 1/2, tax payments from newly constructed properties also work to mitigate increases on existing properties. For FY2004, the levy increase of $11.9 million is offset by the $11.3 million in taxes paid by new construction (see table I).

TABLE IV
Changes in Average Tax Bills*

	FY03 Tax Bill	FY04 Value	FY04 Tax Bill	Dollar Change	Percent Change
Single Family	$4,748	$858,322	$5,094	$ 346	7.3%
Condominium	$1,718	$401,342	$1,607	$ - 111	- 6.4%
Two Family	$3,476	$666,855	$3,633	$ 157	4.5%
Three Family	$3,355	$648,198	$3,491	$ 136	4.1%

* Does not include CPA surcharge

TABLE V
Percentage of Properties Above/Below Average Value

	Below	Above
Single Family	71%	29%
Condominium	67%	33%
Two Family	66%	34%
Three Family	60%	40%

TABLE VI
Changes in Average Tax Bills Without New Construction*

	FY03 Tax Bill	FY04 Value	FY04 Tax Bill	Dollar Change	Percent Change
Single Family	$4,748	$858,322	$5,174	$ 426	9%
Condominium	$1,718	$401,342	$1,633	$ - 85	- 5%
Two Family	$3,476	$666,855	$3,690	$ 214	6.2%
Three Family	$3,355	$648,198	$3,546	$ 191	5.7%

* Does not include CPA surcharge

The past year has seen an increase in Residential Real Estate valuation coupled with a decline in Commercial Real Estate valuation. Declining Commercial Real Estate values are a direct result of lower rental rates and increasing vacancy. In past years Commercial Real Estate has increased at a higher rate than the Residential Real Estate, which has been reversed in the past year causing a shift in taxation between the classes.

For a detailed listing of tax bill changes by district please see Attachment 1.

COMMUNITY PRESERVATION ACT SURCHARGE

In November of 2001, Cambridge voters approved adoption of the Community Preservation Act (CPA), a state law that allows the City to receive matching funds from the state for money raised locally in support of affordable housing, historic preservation and protection of open space. The local portion of CPA funding is raised through a 3% surcharge on taxes. Through Fiscal Year 2004, the City has appropriated/reserved a total of $24.1 million in CPA funds, of which approximately $10 million is attributable to state matching funds.

The CPA surcharge has an essentially neutral impact on tax bills because funding of affordable housing, historic preservation and open space initiatives has been shifted from the tax levy to the surcharge. The City continues to allocate the same amount of local funds to these initiatives. However, the state match has enabled the City to double the amount of funding appropriated for these initiatives. To date, Cambridge has received more CPA matching funds from the Commonwealth than any other participating community. Consequently, Cambridge residents will benefit from important housing, historic preservation and open space initiatives throughout the City for years to come.

TABLE VII
Community Preservation Act Surcharge

	FY03 Average CPA	FY04 Average CPA	FY04 Average Tax	FY04 Average Tax & CPA
Single Family	$121	$130	$5,094	$5,224
Condominium	$ 30	$ 25	$1,607	$1,632
Two Family	$ 82	$ 86	$3,633	$3,719
Three Family	$ 79	$ 82	$3,491	$3,573

FY2004 PROPERTY VALUES

For 2004 the City of Cambridge continued its policy of maintaining property valuations reflective of fair market value based on sales. Sales of 346 houses and 593 existing condominium units were analyzed to develop factors to adjust values by property type (one-family, two-family, three-family, and condominium units) and residential assessing district. Although the economy was sluggish in 2002, low mortgage interest rates coupled with the demand for housing led to further increases in sale prices during 2002 calendar year for residential property in Cambridge. As a result, the fiscal year 2004 real property assessment trend factor must reflect this market activity. The most significant growth and increase in value occurred in the condominium market. Single-family and multi-family properties demanded substantial sale prices; however select neighborhoods experienced greater increases in value than the class average. Specifically, there was a net valuation increase of 11% for single-family houses. The greatest increase in the single-family class was found in Districts 2 (Wellington & Harrington), 7 (North/ West Cambridge) and 13 (Cambridgeport) with an increase of approximately 15%. The net value increase for two-family and three-family houses was 12% and 8% respectively. The Condominium class experienced the largest net increase in value at slightly over 14%. Attachment 1 shows a detailed breakdown of the results. The attached map entitled "Residential Tax Districts" shows the Assessing Departments delineation of neighborhoods for the purpose of market analysis.

For commercial and industrial properties, income and expense returns for the 2002 calendar year were compared to the 2001 calendar year returns. From this analysis, factors were developed to adjust commercial values by use (retail, office, hotel, manufacturing, etc.) and by commercial assessing districts.

Two hundred and one (201) new business personal property listings were added to the master file for FY2004, bringing the total number of personal property accounts to 3,149. The new accounts and the new personal property acquired by existing accounts contributed $124.5 million to tax value growth for FY2004.

ISSUES/REQUIRED VOTES

- **Authorize $6,175,000 in Free Cash.** For the fiscal year that ended June 30, 2003, the City of Cambridge has a certified Free Cash balance of $45,049,838, an increase of approximately

$16,300,000 from FY2002. The significant increase in Free Cash is attributable to actual General Fund revenues exceeding estimates by a large margin, reconciliation of grant revenue and expenditures and the elimination of reserve for capital projects category. While the $4,175,000 Free Cash authorization requested at this time was included in the FY2004 budget, an additional $2 million has been recommended. The Department of Revenue (DOR) does not allow formal authorizations for Free Cash by the City Council until the DOR has certified a Free Cash balance at the conclusion of the fiscal year.

- **Classify Property and Establish Minimum Residential Factor.** Since 1984, the City Council has voted annually to follow state law allowing the classification of property according to use (residential or commercial) and to allocate the legal maximum portion of the tax levy to the commercial class. State law allows the residential portion of the tax levy to be as low as 50% of what it would be if there were single tax rates. However, there are two exceptions to the 50% minimum:

    1. The residential percent of the levy cannot drop to less than its lowest level since classification was initially voted by the City Council (34.5615% in 1985 in Cambridge); and

    2. The 50% level does not cause the commercial class to bear a portion of the levy greater than 175% of what it would be if both classes were taxed equally.

The City Council sets the levy distribution each year by voting for a Minimum Residential Factor. The result of voting for the Minimum Residential Factor of 56.3907% this year will be a residential property share of the total tax levy of 35.6574%. Commercial property will pay 64.3426% of the levy, which brings the commercial portion of the levy to 175% of what it would be with a single tax rate.

- **Establish Residential Exemptions.** Home Rule Legislation allowing the City of Cambridge to increase the residential exemption from 20% to 30% was filed by a unanimous vote of the City Council and passed by the State Legislature and achieved by a legislative override of the Governor's veto. This change enables the City to grant owner occupants of residential properties a deduction of up to 30% of the average residential parcel value before the tax rate is applied. I am recommending that the City Council accept the Maximum Residential Exemption of 30%. Increasing the Residential Exemption from 20% to 30% increases the value of the deduction from $127,117 to $190,676. This amount is deducted from the assessed value of each owner occupied property prior to applying the tax rate. The residential exemption serves to reduce the effective tax rate on lower valued properties while raising it on higher valued properties. Since the same amount is deducted from every value, its impact is greatest on the lower valued properties. The residential exemption is paid for by raising the residential tax rate sufficiently to cover the number of taxpayers claiming the residential exemption. For FY2003 there are approximately 12,250 resident exemptions on the Assessing Department files. If Cambridge did not adopt a residential exemption, the residential tax rate would be $6.15 instead of $7.63. The higher tax rate results in a "break-even" value over which the higher valued residential properties are assessed for higher taxes than would be the case if there were no residential exemption. In FY2004, the break-even value is $983,000.

For more detailed information about the impact of the 30% residential exemption on taxpayers, see Attachment II.

- **Double Statutory Exemptions.** State legislation requires cities and towns to grant a variety of tax exemptions to elderly taxpayers, blind taxpayers, veterans, and surviving spouses who qualify by virtue of residency, income and assets. There are also two pieces of legislation, which authorize cities and towns to increase the amounts of these exemptions. The first allows cities and towns to double the statutory amounts for taxpayers whose tax bills have increased over the prior year's bill. The City Council must vote annually for this increase. I am recommending that the Council do this for FY2004, as it has since FY1987. The second, enacted in 1995, allows cities and towns to increase the amount of the exemption for a senior citizen 70 or older, surviving spouse, or minor with a deceased parent by the increase in the cost-of-living as measured by the Consumer Price Index (CPI). The CPI increase for FY2004, which was published by the DOR for exemption purpose, is 3.58%. Applying this percentage increase to the FY2003 exemption of $219.78 raises the exemption to $227.65.

- **Increase Income Limit for Tax Deferral.** Another form of tax relief available to property owners under state law is Clause 41A of Section 3, Chapter 59. This statute allows taxpayers over 65 years old to defer tax payment until they are deceased or the property is transferred. The statutory income limit for this deferral is $20,000, which may be increased to $40,000 by local legislative action. I am recommending that the City Council take this action.

- **Account MGL Chapter 184 Section 51, Clause 41C.** The Legislature has approved new options for providing additional property tax relief for seniors. This is the most generous tax relief for seniors since 1982, dropping the age from 70 to 65. Additionally, the income and asset limits to qualify have been substantially increased for singles and married. Four-family occupant owners are eligible for the first time providing they meet the income and asset limits.

  The amount of the minimum senior abatement may be increased from $500 up to $1,000 and this amount can be doubled providing that your property taxes have increased by that amount over the previous year. The new 41C will allow the elderly to receive a minimum reduction of $1,000 and up to $2,000 in tax reduction provided that their taxes have increased.

CONCLUSION

As the City Council is aware, by the time the classification vote is taken in the fall of each year, the options for the City are fairly limited. Failure to approve maximum classification, residential exemption and the doubling of statutory exemptions would result in significantly higher taxes for residential property owners. After the classification vote is taken, the establishment of the tax rate is a fairly simple mathematical calculation: the tax levy required to support the City budget divided by the total assessed valuation equals the tax rate for FY2004. In FY2004 a portion of Free Cash fund balance has been recommended to lessen the property tax rate.

Continued sound financial management has enabled the City to limit the growth of the residential property taxes. FY2003 was a extremely strong year for the finances of the City: its Free Cash position increased, and its excess levy capacity increased for the third straight year. These strong financial indicators combined with a Aaa credit rating provides the City with enormous flexibility to respond to many of the needs facing this community without sacrificing the fiscal stability that the great majority of our residents expect from the City. By adhering to the proven fiscal policies that have served us so well in the past, we can continue to ensure a stable fiscal future for Cambridge.

Very truly yours,

Robert W. Healy
City Manager

RWH/ceg
Attachments